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RAILWAY RATE THEORIES OF THE INTER-STATE COMMERCE COMMISSION. III.

SUMMARY

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VI. Competition (*continued*)

4. *Export rates*

Two questions are raised in connection with this interesting group of cases: (1) Do carriers serving different seaports have a right so to adjust their rates as to promote the export trade of the ports served by them ? (2) If this is done, is the carrier thereby placed under obligation to grant the same rates on goods carried to these ports for domestic consumption as it gives to the export traffic ?

In attempting to answer these difficult questions the Interstate Commerce Commission has had to consider a vast amount of evidence and listen to many able arguments presenting various views as to the principles involved. Its own conclusions show the influence exerted on the minds of the Commissioners by these opposing arguments and conflicting testimony, and make it difficult for the analyst to discover the leading principle involved in the final decision. Yet, throughout all the reasoning

of the Commissioners, there is evident a desire on their part to preserve competition between the various ports and between the carriers leading to these ports, and also to make it possible for American producers to meet the competition of foreigners in the over-sea market. We may, therefore, without much hesitation, treat these cases under the heading of competition.

The questions just presented first came before the Commission shortly after its organization in the shape of a request [1] for its decision as to whether or not it was illegal "for railroad companies connecting Boston with western points to make the rates from such points to Boston upon grain and provisions for export as low as the rates to New York, altho the rates upon like property for local consumption are higher to Boston than to New York, the distance being somewhat greater." The Commissioners rendered no formal decision in the matter but informally replied that it was not illegal. The desire to preserve competition between the two ports with reference to the export trade of the country was the reason given for this informal opinion.

Not long after this a formal hearing was given to a case brought before the Commission [2] in which that body was asked to grant an order compelling the defendant carriers to make as low rates on goods sent to Boston for domestic consumption as they gave on the same traffic when taken to New York. The contention was that since equal rates were given to the two cities on goods intended for export and it cost no more to haul goods for domestic consump-

[1] In re Export Trade of Boston, 1 I. C. C. Rep. 24.

[2] Boston Chamber of Commerce v. L. S. & M. S. R'y Co. et al., 1. I. C. C. Rep. 436.

tion than when they were to be exported, the two cities should have the same rates on their domestic traffic. We have already seen [1] that the Commission denied this plea on the ground that the natural advantages possessed by New York entitled her to lower rates on goods intended for domestic consumption.

The next case to bring these questions before the Commission was that of *The New York Produce Exchange v. The New York Central and Hudson River Railroad Company et al.*[2] It appeared from the evidence submitted that the carriers known as the Trunk Lines were in the habit of accepting as their share of the through export rate to European ports ten cents or more per hundred pounds less than the published domestic rates to New York City. The purpose of the discrimination was evidently to favor the export trade of New York. The Commission seems to have preferred not to discuss at this time the question as to whether it was legitimate as a general principle to charge lower rates on traffic intended for export than on that intended for domestic consumption. Its decision in the present case was against the continuance of lower export rates at New York, but the reason cited was that "any method for making rates should be practicable, and not afford a cover for discrimination and injustice." The only practicable method of making export rates, it was said, was to add the established inland rate from the interior to the seaboard to the current ocean rate.

The task of attempting a settlement of the controversy between the seaboard cities as well as between the trunk lines over export rates could not much

[1] Quarterly Journal of Economics, February, 1911, vol. xxv, pp. 294–296.

[2] 3 I. C. C. Rep. 137.

longer be evaded and in 1898 such a settlement was attempted by the Commission, after a thoro investigation, in the case of *The New York Produce Exchange v. The Baltimore and Ohio Railroad Company et al.*[1]

The complainant in the case attacked the differentials on grain, flour, and provisions made by the various lines from the West in favor of Philadelphia, Baltimore, and other cities. As compared to New York rates these differentials favored Philadelphia to the extent of 2 cents per 100 pounds, while Baltimore, Newport News, and Norfolk received a differential of 3 cents per 100 pounds. Boston, on the other hand, paid the same rates on export traffic as were paid to New York. The differentials applied to freight of all classes shipped from Chicago and from territory between Pittsburg and the Mississippi river and between the Ohio river and the Great Lakes. The differentials were somewhat less on traffic coming by the Great Lakes and on that carried on commodity tariffs, but in all cases the rates on export traffic were lower to Philadelphia and Baltimore than to New York.

The history of the differentials showed that they had been applied in one form or another since 1869. They had given rise to many contentions between the cities on the Atlantic seaboard and had caused many destructive rate wars between the carriers leading to the several ports. The struggles "were mostly over export traffic and the differentials were insisted upon and were allowed for the purpose of permitting the various carriers to enjoy a portion of that traffic." The contest between the cities was more bitter than that between the roads; and some

[1] 7 I. C. C. Rep. 612.

of the carriers, weary of the long struggle, requested certain eminent men with legal training and judicial experience to act as an advisory commission to aid in finding a solution to the problem. These gentlemen made an elaborate investigation covering several months and reported in July, 1882.

> The conclusion at which they arrived was that distance could not be used as a measure of these differentials; neither could cost of service. Competition which embraced these two, and all other factors, if properly conducted through a series of years was the most reliable guide. Competition, after many years, had resulted in fixing the differentials in force. Those differentials were justified to a certain extent by distance and to a certain extent by cost of service. The purpose of the differential was to equalize the cost of exporting grain and other merchandise through the various ports to which they were applied. A difference in ocean freight rates from those respective ports, corresponding generally to the inland differentials, was found to exist. Upon the whole, therefore, the [advisory] commission declined to recommend that the differentials which had been agreed upon should be disturbed.[1]

When the case came before the Interstate Commerce Commission the complainant urged: (1) that the differential was not fair in principle, and (2) that even if the conclusion reached by the advisory commission in 1882 were sound, conditions had so changed since that time that the decision of that year could no longer be held applicable. Philadelphia and Baltimore claimed that the differentials in their favor gave only proper recognition to the fact that the distance from Chicago to those ports was less than to New York. New York interests, however, declared that the wheat of Wisconsin, Minnesota, and the Dakotas was in a territory naturally tributary to New York and that the differentials thus robbed that city of its natural geographical advantages.

[1] 7 I. C. C. Rep. 619–620.

To offset this claim, however, Baltimore declared that the corn territory was naturally tributary to that city. The Commission found it impossible to determine the origin of the traffic, as it varied from year to year.

The New York interests further claimed that differences in cost of service did not justify the discrimination against New York, and that if the object of the differentials was to equalize the cost of exporting grain through the various ports, " then the cost of grain in Europe should be the same by each port whereas, in point of fact, it had been less through the outports than through New York." The results of this discrimination were shown in the decline of the export trade of New York in flour, grain, and provisions since 1873, especially during the '90s, while during those years exports had remained about the same at Philadelphia and had greatly increased at other ports. The Commission discovered on investigation that New York had certain advantages over the other ports for conducting the export business, such as were due to her large and accessible harbor, the accumulation of wealth and business which brought many ships there, her elevator storage capacity, and the Erie Canal. On the other hand, the port of New York labored under certain disadvantages due to the heavy port charges, especially for lighterage, and perhaps to more rigid grain inspection than at other ports. The Commission concluded that " so far as the full cargo business is concerned, there is no appreciable difference in cost, and no appreciable difference in the ocean rates from the three ports, New York, Baltimore, and Philadelphia." In respect to " berth rates " (for quantities less than a full cargo) New York appeared to have an advantage over other

ports owing to the large number of steamships sailing from that port.

On the whole, however, efforts to reach a solution of the problem based on a comparison of differences in distance or on the relative costs of service did not yield satisfactory results to the Interstate Commerce Commission, any more than it had to the Advisory Commission of 1882, or to Mr. Albert Fink, or to the other traffic experts who had at various times grappled with the problem. The Commissioners agreed with the earlier investigators that the differentials were based not on differences in distance or in the cost of service but on competition, and that if they were to be justified at all it must be on the principle of preserving competition between the ports and between the carriers which served these ports.

> The primary purpose of these differentials is not to do justice to a particular port but to enable the various competing lines to obtain a fair proportion of this traffic. In other words, the reason for these differentials is competition between railways. Cost of service and distance are very likely taken into account by the defendants in determining whether under the operations of the differentials a particular line has obtained more than its share of the traffic, but the underlying principle is competition.

Having concluded that competition was the principle upon which the differentials were based, the Commissioners next discussed the question as to whether this principle was itself just. They quoted from decisions of the United States Supreme Court [1] to show that competitive conditions do not necessarily but "may justify the preference of one locality to another, provided the interests of the public are not unduly sacrificed to those of the carrier." This

[1] Tex. & Pacif. R'y Co. v. Interstate Commerce Commission, 162 U. S. 197; 5 I. C. R. 405. Interstate Commerce Commission v. Alabama Midland R'y, 162 U. S. 144.

however is clearly a legal argument; not an economic one. It is more important to observe the grounds on which the Commission attempted to sustain the existing differentials.

Since competition was the basis, the object of the differentials, it was shown, was to make the cost of transporting such articles as grain from Chicago to Liverpool the same through all ports.

> Any difference in the expense of ocean carriage should be equalized by a corresponding difference in the cost of inland carriage. . . . Broadly speaking, the differential is supposed to correspond with and make good a difference in the ocean freight rate.

While, however, the differentials at the time of making the investigation (1896) were the same as when first established in 1878, " the gradual lowering of rates, the shrinking of values, the increase of competition, have all operated to make the differentials in favor of Baltimore and Philadelphia mean more today than they did when agreed upon." The Commission however declared (as had the advisory commission of 1882) that while neither considerations of distance nor cost of service could justify entirely the existing differentials, the most satisfactory means of testing them was " the result of their operation." New York was of course quick to point out that this result had been a great decline in her export trade since the differentials went into effect. But the Commissioners, while admitting that there had been a decline, expressed the opinion that this was in keeping with the natural development of the nation and that New York's early preeminence in the export trade had been due largely to artificial conditions which had since been changed by " other strong influences " operating in favor of other ports.

The Commissioners agreed, however, that owing to the fact that the differences in ocean freight rates from the different ports were at that time less than the amount of the differentials, and that the differentials were having more effect than they had in 1877, these two circumstances "would point strongly to the conclusion that they ought to be modified." The Commissioners did not order any modification, however, and their explanation for not doing so is the least satisfactory portion of their reasoning.

The differentials, it was said, applied to all classes of freight and accordingly affected all commodities. But the exports of higher grade than wheat went almost entirely to New York, where they could find quicker service to all parts of the world. Now, said the Commissioners,

> if the quantity of these exports, which the differential does not divert to Baltimore or Philadelphia has been increased in late years, it is manifest that this offsets to that extent any increased diversion of grain to the outports. . . . So it is by no means certain that more grain ought not to go through the outports to offset the increased exports of other kinds from New York.

According to this peculiar reasoning the advantages possessed by Baltimore and Philadelphia do not entitle them to as large differentials as they are actually receiving, but this is "offset" by the fact that New York's natural advantages enable her, *in spite of the differentials,* to secure a larger percentage of the high-grade exports than formerly. This fallacious argument is made still weaker by the Commissioners' plea that

> if we have made an error, it is in favor of the weak and against the strong. . . . It is almost impossible for us to feel that a locality which engrosses one-half of all the exports and three-fourths of all the imports upon the seaboard can justly complain of any undue diversion of its commerce.

Since our purpose is to interpret rather than to criticise the Commission's conclusions we will not follow the argument further, but will conclude our presentation of this case with the Commission's own summary, which shows clearly that in rendering their decision the Commissioners were convinced that competition long maintained afforded the best method of judging as to the reasonableness of the rates in question.

The principle upon which these differentials have been established is legitimate. Looking to the basis of the differentials themselves, while there is much to indicate that they should perhaps be somewhat modified, it cannot be affirmed with certainty that they are wrong. Considering their effect as exhibited through a long series of years, it is impossible to say that they have exercised any untoward or unnatural influence upon traffic.

The decisions of the Interstate Commerce Commission in the later cases dealing with export rates which have come before it have been much influenced by the decision of the United States Supreme Court in the *Import rate case* [1] in which the Court, over-ruling the Commission, held that

among the circumstances and conditions to be considered, as well in the case of the traffic originating in foreign ports as in the case of traffic originating within the limits of the United States, competition that affects rates should be considered, and in deciding whether rates and charges made at a low rate to secure foreign freights which would otherwise go by other competitive routes are or are not undue and unjust, the fair interests of the carrier companies and the welfare of the community which is to receive and consume the commodities are to be considered.

By inference, at least, this decision of the Supreme Court would apply to the export as well as to the import traffic, especially since competition is dis-

[1] Tex. & Pacif. R'y Co. v. Interstate Commerce Commission, 162 U. S. 197; 5 I. C. R. 405.

tinctly set forth as a reason why lower rates might be granted by carriers to commodities intended for export than were granted to the same articles when intended for domestic consumption. With this case as a precedent, therefore, the Commission decided in the case of Boston export traffic [1] that even tho these goods were not shipped on a through rate, they might legitimately be charged lower rates than were accorded to the same goods intended for domestic consumption. "The export rate to Boston," said the Commissioners, "is not in reality a Boston rate at all but is in essence the inland division of a through rate through that port to foreign ports."

The principle underlying this decision is clearly not cost of service but competition. The decision is in accord with the informal opinion rendered in the case of the *Export Trade of Boston*,[2] but is not in agreement with the rule laid down in *New York Produce Exchange v. New York Central and Hudson River Railroad Company et al.*[3] The language of the Commissioners also indicates that they believed it correct in principle to apply a different ruling in the case of Boston export traffic than they would apply at New York. For, while they admitted that their decision in the present case was influenced more or less by the Supreme Court's decision in the import rate case, they practically assumed full responsibility for their own decision by stating that the decision of the Supreme Court did not carry with it any obligation on the part of the Commission to sanction lower rates on import or export traffic than on domestic traffic, but merely required that "in determining whether such rate constitutes an unjust

[1] Kemble v. B. & A. R. R. Co. et al., 8 I. C. C. Rep. 110.

[2] 1 I. C. C. Rep. 24.

[3] 3 I. C. C. Rep. 137.

discrimination or an undue preference, the interest of the carrier and the consumer should be taken into account as well as that of the producer." The Commission therefore declared that "if any individual or locality feels itself aggrieved by the rates made upon export or import business as compared with domestic business, the Commission has full authority to consider and pass upon that grievance." So far as Boston export traffic is concerned, therefore, there appears to be no difference in the opinions of the Court and the Commission. Both tribunals agree that competition is the controlling principle in the case.

The real difference in the opinions of these two bodies is best revealed in the Commission's report on an investigation made by it in 1899, *In the matter of relative rates on export and domestic traffic in grain.*[1] Two questions were involved: (1) To what extent, if at all, might the carriers make a different rate on grain intended for export than that given to the same commodity when intended for domestic use? (2) Might there be a legitimate difference made between the export rate on grain and that on its chief products, flour and meal?

With reference to the first point, the evidence showed that the railroads connecting the Middle West with the Atlantic seaboard were giving a rate of 12 cents per 100 pounds on grain shipped from the Mississippi river to New York when it was intended for export, and at the same time were charging 19½ cents per 100 pounds on the grain when it was intended for domestic consumption. The carriers claimed that "it is a matter of no consequence to the eastern consumer what rate is charged to the foreigner, provided

[1] 8 I. C. C. Rep. 214.

the domestic rate is a reasonable one." This argument did not appeal to the Commissioners. They replied:—

> To this proposition we cannot fully assent. In the first place the foreigner is to an extent in competition with the American. Both are engaged in the production of articles sold in the same market either abroad or in the United States. If the Englishman can procure the necessities of life cheaper than his American competitor, that gives him the advantage. . . . Unless there is some good reason for the distinction, the rate to the American ought not to be higher than to the foreigner. If our carriers, in the absence of any constraining reason, can transport corn from the Mississippi river to New York for 12 cents per hundred pounds for export, that of itself shows that a rate of 19½ cents to the domestic consumer is unreasonable.

The carriers made some effort to show that the cost of service was less for the export than for the domestic traffic owing to bulk of shipments, methods of unloading, etc., but the Commission dismissed this argument with the statement that the evidence on this point was insufficient. The main ground of defence occupied by the carriers was that competitive conditions existed in the case of the export traffic in grain which did not exist in the case of grain intended for domestic consumption. The competitive conditions were of two sorts: (1) competition in the European market between American producers and those of other grain exporting countries; (2) competition between the carriers engaged in transporting export grains.

With reference to the first form of competition the defence claimed that the price of wheat was fixed both at home and abroad by the foreign market and it was said that if the price of wheat abroad were lower than the price in this country plus the established rate for transportation, then either the price of wheat must be reduced or the rate of transportation must

be lowered. By pursuing the latter course, the carriers claimed that the American producer received the entire benefit from the reduction of railway rates. This patriotic and philanthropic mode of procedure on the part of the railroads did not greatly appeal to the Commissioners. They did not accept the statement that the foreign market fixed the price of American grain and said, "As an actual fact it is doubtless true that the price of grain, certainly wheat, abroad is fixed neither by the foreign nor by the American supply alone, but by the one acting upon the other." The facts, furthermore, did not show that at the time of the investigation the low rates on export grain had been rendered necessary by the condition of the foreign market, but they did show, according to the Commissioners, that "the American producer has derived no substantial benefit from these rates; that the American carrier has lost enormously by them, and that the foreigner alone has had the benefit of them."

The Commission was willing to attach more importance to the second form of competition cited by the defence, viz. that between the carriers themselves. This competition was three-fold in character: (1) that between the trunk lines and those running to the Gulf ports; (2) that between the trunk lines themselves; and (3) that between the railroads and the water routes, especially the Great Lakes, St. Lawrence river, and the Erie Canal. This competition, the Commissioners were compelled to admit, must be considered in judging as to the reasonableness of the export rates, tho they declared it had "sacrificed millions of dollars" of revenue of American railroads. "Nor would we," said they, "permit the continuance of such a system if we had the power to prevent it."

Owing, however, to the influence of water competition, as well as to the fact that "the purpose of the act was to foster competition," and "the highest judicial authority has declared that competition between railways may be a reason for making a lower charge to the more distant point," the Commission confessed itself powerless to order carriers to make their rates on domestic traffic as low as that given on the export traffic.

The question as to whether or no it was legitimate to charge a higher rate on grain products than on grain, when both were intended for export, was answered by the Commission on much the same principle as was applied to the settlement of the controversy over the domestic and export grain rates. The carriers sought to justify the higher rates on flour than on grain on several grounds: (1) Cost of service. Flour was said to be more liable than wheat to injury; wheat moved in train load lots; wheat was delivered in New York *at* the ship's side, flour *over* the ship's side. The Commission admitted some difference in the cost of service but thought it would not exceed one or two cents per hundred pounds. (2) The carriers urged that the general rule that manufactured products should pay a higher rate than raw materials was applicable to this case and that the value of the flour was greater than that of the wheat. The Commission said that "when it is remembered that the cheaper grades of flour are usually exported, it is questionable whether the difference is material." (3) Water competition, a prominent factor in connection with the movement of wheat, was shown to be of less importance in case of the flour traffic. Hence, in spite of strong evidence submitted by the millers, showing that the profits from manufacturing flour

for export were only from one to two cents per hundred pounds, the Commissioners said: "We think and find that the lake competition fairly fixes the rate on flour at from two to four cents per hundred pounds above the wheat rate." In spite of the fact that water competition as well as competition between the railroads was a real factor in the case, and that both the law and the courts compelled its recognition, the Commission evinced throughout the entire case a strong feeling that this competition was bad policy not only for the public at large but even for the carriers. This feeling, as well as the desire to go as far as they could go in sustaining American millers in their competition with the milling industry abroad, led the Commissioners to decide that "the rate upon flour for export ought not to exceed that upon wheat by more than 2 cents per hundred pounds."

Three years after the Commission had rendered its decision in the above case, the trunk lines leading to the East from Chicago and the Mississippi river gave notice of an advance to be made in the rate on grain from a former published rate of 17½ cents per 100 pounds (which, however, was seldom maintained) to a rate of 20 cents per 100 pounds. When the Commission undertook an investigation [1] of the causes and justification of the increase, the carriers gave as reasons: (1) changes in commercial conditions, and (2) cessation of competition to a degree which made it easier to maintain published rates. The Commission did not discover that there had been any such change in the commercial conditions for producing, shipping, and marketing grain as would warrant an advance in the rates, but the second

[1] In the matter of proposed advances in freight rates, 9 I. C. C. Rep. 384.

reason advanced by the carriers seemed a more plausible explanation for the increase.

The intense competition which had for years existed between the lines leading from the West to the Atlantic seaboard had been, if not ended, at least in a measure brought under control by purchase of large blocks of stock in the most troublesome of these competing lines by the two strongest lines, the Pennsylvania and the New York Central railroads. This purchase and resulting control of the weaker lines by the stronger ones made it seem much more likely that in the future the published rates could be maintained.

The Commission refused to justify the advance in the published rates from 17½ to 20 cents per 100 pounds. They called attention to the fact that the language of the act to regulate commerce and the decisions of the Supreme Court in interpreting that act and the Sherman Anti-Trust Act showed that public opinion reflected in legislation and judicial decisions was unwilling to concede that competition in the railway business was not a proper means of regulating freight and passenger business. The Commission's discussion of the matter shows clearly its own belief that competition between railways was frequently of such a character as not to guarantee reasonable rates.

It has been frequently observed that competition in rates under the act to regulate commerce is a misnomer. This grain rate between Chicago and New York must be the same by all lines. If any one line reduces that rate, every other line must make a corresponding reduction or withdraw from the business. No line can, therefore, hope to gain a permanent advantage by a reduction in the published tariff. So long as rates are observed there can be no competition in the rate, altho there may be in facilities. Such competition necessarily consists in departures from the published rate. Such competition does not, however, materially increase the total amount of traffic. It may turn additional tonnage to a

particular line temporarily, but the total result is a reduction in the aggregate gross and net revenues of all lines and probably in the net revenue of every individual line.

To the Commission, therefore, the mere fact that competition in rate making is shown to exist is not a sufficient proof that the resulting rates are reasonable. Competition may make the rates too low. The railroads insisted that this was true in the present instance and claimed that even the former published rate of 17½ cents per 100 pounds was so low that it was unremunerative. To decide this point the Commissioners made an investigation into relative costs of moving grain and other commodities, with the following results: —

Of all commodities grain is among the very most desirable species of traffic. It moves between Chicago and the Atlantic seaboard in large quantities, frequently in train loads. Cars can be loaded to their full capacity. The nature of the business permits prompt loading and unloading. The character of the service required allows the most economical handling of trains with respect to rate of speed and other operating conditions. There is hardly any kind of traffic moving from Chicago to the Atlantic seaboard which can be transported at less cost to the carriers than grain. . . . The first reason urged by the carriers for advancing these rates beyond the competitive point is not therefore sustained. Whether tested by the actual cost of movement, by what carriers have voluntarily accepted in the past, or by comparison with other somewhat similar kinds of traffic, this rate is not, in our opinion, extravagantly low.

While the Commission, therefore, still held to the theory that competition was the controlling factor in the case, the competition which they recognized as legitimate was that limited in its operation by cost of service.

The ever-perplexing problem of the differential rates between the North Atlantic ports came up

once more in the year 1904, when the Commission, at the request of the commercial organizations of Boston, New York, Philadelphia, and Baltimore, instituted an inquiry [1] into the reasonableness of the railway rates to and from these cities with the purpose of determining whether the existing differentials should be abolished, or, if retained, be modified. The Commission admitted that it had no authority to compel the carriers to accept its conclusions, but for our purpose this fact is of no importance, since we are interested only in the Commissioners' views as to the principles involved.

On the whole, the conclusions reached did not differ materially from those arrived at in the earlier investigations. The Commission seems to have felt that the earlier decisions were not based on any fundamental principle of rate making and in the present instance they declared: "We have endeavored to find some fundamental principle by the application of which this dispute might be laid to rest, but entirely without success." The evidence showed that since the last hearing on the subject the differentials which had formerly existed in favor of Baltimore and Philadelphia had been greatly reduced, especially on grain and on iron and steel, where they amounted to only one-half the old differentials. The reason for the change was that there was no longer any considerable difference in the ocean rates from the various ports. Baltimore claimed indeed that "on the basis of distance the present rates did not give that locality anything like the advantage to which it was entitled." To this argument the Commission pertinently replied: —

[1] In the matter of Differential Freight Rates to and from North Atlantic Ports, 11 I. C. C. Rep. 13.

It must be evident that distance is properly regarded as a factor in rate making mainly because it is supposed to express differences in the cost of service. . . . The grades by the New York Central lines between Chicago and New York are easier than those by the Pennsylvania and it is quite conceivable that the actual cost of transportation over the longer haul might be less than over the shorter, and in that event New York, while more distant in geographical miles, might be nearer in transportation facilities.

The Commissioners did not concede, however, that cost of service could be made use of as a principle for finding a solution to the problem. They said: —

Nothing of all that need be considered by us. There is no testimony in this record which attempts to show the relative cost of handling this traffic from Chicago to the different ports, and indeed, as was said by the Advisory Commission in 1882, the elements which enter into the determination of that question are so complex and so various as to render it impossible of satisfactory solution.

Having declared that in this case "there is no fundamental principle which can be applied," the Commission nevertheless insisted that "there are certain fundamental considerations which should be kept in mind." In the opinion of the Commission, these fundamental considerations were: (1) the maintenance of competition between the ports; (2) the maintenance of competition between the carriers.

(1) If it can be properly done, these ports should all be kept open for the transaction of this export business upon such terms that each one may fairly compete for it. No marked advantage should be given, certainly not by the creation of artificial conditions, to any one port over the other. *The ideal conditions would be the establishment of such rates that enterprise at either port in the way of improvement in service or facilities might be rewarded by increased business and that there might exist that healthy struggle of locality against locality which is the best security for proper commercial development.*

(2) If again it can properly be done, then rates should be so adjusted that this competitive traffic will be fairly distributed between the different lines of railway which serve these ports.

Each one of these four cities is reached by two or more great railway systems. The prosperity of these cities and systems cannot be separated. The ability of a railroad to adequately discharge its duty for a reasonable charge depends upon the business which it can obtain, and no one of these systems should be deprived of its fair portion of this enormous export traffic. The purpose of these differentials from the first has been to distribute this business between the different carriers and we said in our former report that this was not improper unless the means used were improper.

This double competition between cities and between railroads was the fundamental consideration which in former times had led to the granting of a differential rate of three cents in favor of Baltimore and of two cents in favor of Philadelphia. Under changed conditions this same competition had in 1899 caused a reduction of these differentials by one half. For the same reasons which had led it to uphold the former differentials the Commission in the present case declared: "We are satisfied that the differentials of one cent and one and one-half cents, which were then [1899] established and which are still in effect, are sufficiently large." Some slight modifications were recommended in the existing differentials on flour and on grain coming by way of the Great Lakes.

It would appear from this long discussion of the export rate cases that while competition was selected by the Commission as the ruling factor in the determination of rates, its selection was a matter of expediency rather than of principle. The Commissioners seem to have felt that this competition did not itself represent any "fundamental principle." Much in their reasoning indicates that they would gladly have reached a decision on the basis of cost of service if the facts showing such cost had been at hand. Yet it is by no means certain that they

would have preferred to rest their decision on cost of service. The idea that competition creates "the ideal condition" for the distribution of traffic among the ports is carried so far in the last case considered that the majority of the Commissioners said: "It is possible that in the future it may become evident that Boston cannot fairly compete for this traffic upon the present basis," and hint that should this prove to be the case it might become necessary to give Boston a lower rate than that given to New York; this too in spite of the fact that the cost of moving traffic to Boston is admitted to be greater than to New York.

The same emphasis on competition is shown in answer to New York's claim that the maintenance of any differential forces traffic out of its natural channels and imposes a burden on the public. The Commission replied: "To decree that traffic should always move by the cheapest route would be to entirely eliminate competition, which within reasonable bounds is for the interest of the general public."

It would be hard to say how far this un-economic sentiment, which makes of competition an end instead of a means to an end, expresses the real judgment of the Commission; how far it is merely a reflection of the spirit of the act to regulate commerce and of the decisions of the courts.

5. *Competition between producers*

Besides seeking to maintain competition between the carriers themselves and between places, the Commission has shown no little concern over the maintenance of competition between producers. Generally speaking, its efforts in this direction have been made

in behalf of the small producer or dealer who was in danger of being driven out of business by a more powerful competitor. The Commission has apparently felt that it was charged with the duty of checking the growth of monopoly in the field of production as well as in that of transportation.

In the case of *The F. Schumacher Milling Company et al. v. The Chicago, Rock Island, and Pacific Railway Company et al.*,[1] the complainant asked that the carriers be required to give the same rates on a mixed car load of cereal products as they gave to a car load of only one of these products. The defendants had been in the habit of charging the ordinary less than car load rates on such shipments. Generally speaking, the Commission has been inclined to favor the granting of car load rates on mixed car loads of similar products.[2] In the present instance it declined to order a car load rate on the mixed car load shipments. The advantage of such a rate would fall to a single producer, the complainant, since no other producers of these commodities could ship in car load quantities.

To grant a mixed car load rate would enable the complainant to crush out all competition on the part of those who make only one or two of the products in controversy. It is undoubtedly true that neither the Commission nor carriers are charged with any particular oversight over localities or authorized to stimulate them with artificial helps to prosperity. But when a method of regulation would have the effect of throwing many competitors out of the trade, and centralizing it in the hands of one or more dealers, it would not be permissible if another method, without doing wrong to any one, would have the effect of leaving the market open to all competitors. The rule is simply a limitation put upon the extension of the car load rate, and should be proven by the complainant to be unfair, unjust and discriminative, if its abrogation is sought.

[1] 6 I. C. C. Rep. 61; 4 I. C. R. 373.

[2] See for example 5 I. C. C. Rep. 633 and 9 I. C. C. Rep. 602.

For the same reasons the Commissioners ordered [1] a reduction in the rates on soap shipped in car load lots. The carriers had recently changed the classification so that soap, having been placed in fourth class when shipped in car load lots, was thereafter to pay "20 per cent less than third-class rates." At the same time shippers who shipped soap as part of a mixed car load from one consignor to one consignee were to be charged only the "highest minimum car load rate provided for any of the articles" so shipped. It was shown that the only soap manufacturers who could avail themselves of this privilege were the big meat packers who by making up a mixed car load of provisions and soap could receive fifth-class rates on the entire car load, while their competitors who manufactured only soap would be obliged to pay the 20 per cent less than third-class rates. The Commissioners held that such discrimination was opposed to the principles of competition between producers and assisted materially in the fostering of monopoly.

Still another illustration of the same principle is found in the case of *Brownell et al. v. Columbus and Cincinnati Midland Railroad Company et al.*[2] The complainant demanded that the rates on a car load of eggs be made less than the rates given on less than car load lots. This demand the railroad had refused. The complainants claimed that the cost of gathering eggs by the carrier was much less when they were shipped by the large dealer than when shipped by the small dealer and that if the carrier made no difference in the rates it was guilty of a discrimination against the large dealer. The defendants, on the

[1] The Proctor and Gamble Company v. C. H. & D. R'y Co. et al. 9 I. C. C. Rep. 440.

[2] 5 I. C. C. Rep. 638; 4 I. C. R. 285.

other hand, claimed that they had for years been developing a system of reaching the small dealer in eggs and that this was to the interest of the public at large as well as to the interest of the carriers, since the effect of granting lower rates on car load lots would be to concentrate the egg business into the hands of the large dealers who could then, by threatening to throw all their business to one road, compel unfair concessions from the carriers.

It was this argument of the defendants which prevailed in the minds of the majority of the Commissioners and led them to refuse the request for a car load rate. They gave some consideration to the cost of service arguments of the complainants but declared that only a few points of difference in the cost of car load and less than car load shipments had been shown to exist. On the other hand, they said:—

> The evidence shows that at the present time 83 per cent of the business is controlled by these large shippers, and it would seem that an order granted as prayed for by complainant would go far towards concentrating the whole business in their hands. The tendency of the times, deplored by all, is the concentration of the transportation business of the country in the hands of a few individuals who control large amounts of business. This interferes with competition, and works an injury to many who are almost as well equipped for the business as those who in the end succeed by a concentration of power in the hands of a few to rule out all below them.

Commissioner Knapp, who united with the majority of the Commission in the final decision, declared that carriers were not bound as a matter of right to offer special car load rates. "It is one thing to concede the right to make a car load rate, it is quite another to require it." Commissioner Morrison, on the other hand, dissented from the conclusions of his fellow

commissioners and held that when, as in the present instance, a lower cost of service for car load shipments could be shown to exist, car load rates were required as a matter of principle.

In another instance[1] where the right of a carrier to give a lower rate on a cargo or train load of wheat than on single car load shipments was brought in question, the defendants were able to show that the costs of handling and shipping the wheat in train loads was less and the time saved was greater than in the case of single car load shipments. The Commission held that such a practice "must tend very strongly to throw business into the hands of the larger dealer exclusively," and was therefore not permissible.

In the case of *Glade Coal Company v. Baltimore & Ohio Railroad Company*,[2] it was shown that the defendant carrier was charging 50 cents per ton more on coal loaded from wagons or sleds than when it was loaded from a tipple. The reason given for the discrimination was that loading from tipple could be done at less expense to the carrier and usually in less time than when the cars were loaded from a wagon.

The Commission acknowledged that the costs of loading cars were less when the loading was from a tipple than when it was from wagons, but it did not consider the difference in costs sufficient to warrant the discrimination in rates. Such discrimination was found to result in a reduction in the number of shippers and the Commission said:—

We do not consider it at all clear that the interests of the public, in the true sense of the term, would be subserved by a reduction in the number of shippers and shipping points. On the contrary we think such interests demand that all persons wishing to ship

[1] Paine Bros. & Co. v. L. V. R. R. Co. et al., 7 I. C. C. Rep. 218.

[2] 10 I. C. C. Rep. 226.

goods to market shall be given a reasonable opportunity to do so. Competition is considered a public benefit and the greater the number of shippers the greater the competition among them will be. . . . If carriers are allowed to make differences in the cost of transportation, and see fit to do so regardless of the effect upon shippers and localities, the ultimate result must be that the bulk of the traffic will be handled by comparatively few shippers and from and to large centers. We cannot believe such a result was either intended or desired by the framers of the regulating statute.

In all the cases in this group it will be observed that the Commission has given competition a distinct preference over costs of service as a means of determining the reasonableness of the rates in question.

6. *Competition to prevent a transportation monopoly*

We have already observed that in numerous instances the Commission has considered that competition between carriers was a sufficient excuse for certain discriminations in rates. It has also appeared that the decisions of the courts have compelled the Commission to enlarge the number of these cases. In view of the importance thus given to competition as a regulator of rates, it goes without saying that the Commission would view with displeasure all efforts on the part of the carriers to take advantage of the disappearance of rivalry to raise their rates above the point at which a normal competition would have tended to fix them. The progress of railway consolidation within the last fifteen years has brought about numerous instances of such rate increases. Some of these increases have been brought to the attention of the Commission by shippers seeking relief.

In the case of the *Central Yellow Pine Association v. The Illinois Central Railroad Company et al.,*[1] an

[1] 10 I. C. C. Rep. 505.

association of persons engaged in the manufacture of lumber in the southern states east of the Mississippi river complained of a steady advance, covering a period of several years, in the rates on lumber to points on the Ohio river and beyond. The carriers gave two reasons for the advance: (1) The increasing value of the service; the business of manufacturing lumber was yielding increasing profits and the carriers by their rate advances were seeking to share in the general prosperity. (2) Cost of service; higher wages and increased cost of materials made it necessary to increase the rates on lumber, which had not been yielding its fair proportion of the revenues needed.

Postponing for the present the Commissioners' discussion of the carrier's claim to share in the increased prosperity of the shippers, we may say that they did not find that either cost of service or value of service warranted the increase in rates. These advances in rates, it was shown, had been brought about as a result of an agreement reached between the roads east of the Mississippi river and the roads west of that river engaged in the lumber traffic. The majority of the Commission decided (Messrs. Knapp and Fifer dissenting) that this agreement, whether unlawful or not, had resulted in the elimination of competition and "competition is favored by the laws."

The ground upon which competition is favored is that it conduces to the reasonableness of rates or to the protection of the public from unreasonably high or excessive rates. In *United States v. Freight Association* (168 U. S. 339) the Supreme Court says "competition will itself bring charges down to what may be reasonable." The act to regulate commerce (section 1), in prohibiting unreasonableness of rates, in effect forbids whatever conduces to such unreasonableness. In any event it is incumbent upon this Commission, when the reasonableness of rates is in issue before it, to consider how those rates were brought about — whether they are the product of untrammeled competition or the result of a

concert of action or combination between the carriers establishing and maintaining them. The advanced rates complained of cannot be claimed to be the outcome of competition, because " the natural, direct and immediate effect of competition is to lower " (177 U. S. 577) rather than to advance rates.

The case of *H. H. Tift et al. v. Southern Railway Company et al.*[1] presented much the same situation as the above case and the Commissioners reached the same conclusion as to the necessity of maintaining competition.

In another case,[2] altho the Commission did not claim any jurisdiction, it expressed the opinion that railroads subject to the act to regulate commerce had no right to refuse to enter into an agreement with a boat line engaged in the coasting trade when at the same time it had made such an agreement with another line engaged in this business. The Enterprise Transportation Company was a steamship company which in June, 1905, began to engage in traffic by boat between Fall River, Massachusetts, and New York City. Prior to its establishment the various boat lines operating on Long Island Sound were consolidated under the name of the New England Navigation Company, which was controlled by the New York, New Haven, and Hartford Railroad Company. In this way the New Haven road had secured a virtual monopoly on transportation between southern New England and New York. The establishment of the Enterprise Company had resulted in lowering considerably the rates of transportation between Fall River and New York; but the railroads running west from New York had refused to enter into any

[1] 10 I. C. C. Rep. 548.

[2] In the matter of alleged unlawful discriminations against the Enterprise Transportation Company by railroad lines leading from New York City, 11 I. C. C. Rep. 587.

joint rates with this company, altho they had such arrangements with the New England Navigation Company. This compelled the Enterprise Company to depend entirely on local traffic, as the low through rates furnished by the joint-rate agreement between the New England Navigation Company and the railroads made it impossible for others lacking such arrangements to compete with them.

The railroads upheld their refusal to enter into joint-rate agreements with the Enterprise Company on what they called "business principles." Such a joint rate they held would not increase the amount of traffic from Fall River but would merely put them to the trouble of receiving goods from two lines instead of one. The Commissioners admitted that there was force in the arguments of the carriers, but maintained nevertheless that this throttling of competition was detrimental to the public interests. They said: —

> It is undoubtedly true that better and more efficient service is obtained when competition exists than when the business is entirely transacted by one concern. . . . When the competition of the Enterprise Company had disappeared, rates would be restored to what they formerly were, which, it fairly appears, were higher than reasonable competition would produce. The existence of the Enterprise Company as a competitive factor is of distinct value to the public, and that existence may depend upon its right to engage in through business.

It would be useless, after this long review of the cases in which the Interstate Commerce Commission has seized on competition as the determining factor, to attempt to show that the Commission has been always consistent in its argument as to the part which competition should play in matters of rate making. At times it has seemed to argue that competition itself represents "no fundamental principle" but is only a "consideration which should be kept in mind";

at other times it has given a distinct preference to competition over cost of service as a principle. At times the Commission has believed that competition has made rates too low; at other times too high. Some of the apparent inconsistencies can doubtless be attributed to the changes in membership of the Commission. Other and more serious inconsistencies are due to a desire to preserve the spirit of the act and to respect the decisions of the courts, even when the Commissioners themselves have personally had different views concerning competition. In spite of these inconsistencies, apparent and real, a careful consideration of the cases which we have reviewed and of others not covered will show that it is not merely competition itself which the Commission has sought to preserve and upon which it has at times relied as a guide to the solution of the problems presented; it is rather that type of competition which represents the normal state of business affairs, the competition which leaves to railway owners a reasonable return for the services rendered and which in turn requires them to render these services at what the economist means when he speaks of cost prices.

VII. Class and Sectional Interests

In the discussion of railway rate theories to be found in the First Annual Report of the Interstate Commerce Commission,[1] to which reference has several times been made in this series of papers, we find mentioned among the "considerations which may justly affect rates" the following: —

Every section of the country has its peculiar products which it desires to market as widely as possible, and is not unwilling that

[1] P. 31.

classification should be made use of by the railroads which serve it as a means of favoring and thus extending the traffic in local productions; favoring them by giving them low classification, and thus low rates, and discriminating against those of other sections through a classification which rated them more highly.

The principle that common carriers engaged in interstate commerce and subject to the regulation of a federal statute may legitimately make rates which openly favor one section of the country and discriminate against other sections is a notion so contrary to the spirit of the act to regulate commerce as well as to the Constitution, that we might well hesitate to believe that the Interstate Commerce Commission had intended to give its approval to the above statement were it not for the fact that in its Second Annual Report, as well as in certain decisions, it restates this doctrine in such a fashion as to leave us no longer in doubt as to its approval of this form of discrimination under certain circumstances. The statement in the Second Annual Report [1] reads as follows: —

Every railroad serves a certain territory and every part of the country has to some extent interests to be served which are special and peculiar to it, and these it will naturally desire to have specially considered by local, official and corporate authorities, whether the business in hand be the imposition of taxes or the adjustment of rates for transportation; and as many other circumstances besides cost of transportation and value of service must always be taken into account, such as bulk or weight of articles, convenience of handling, special liability to injury and necessity for speedy delivery, and the field of production or of consumption, so that there can never be any fixed or definite rule for the measurement of the charge to be made upon any particular traffic, it is always possible for the railroad manager in making rates to yield something to the special interests of his section, and still keep in view the general principles upon which he will professedly act.

It is not our purpose in these articles to criticise the work of the Interstate Commerce Commission

[1] P. 35.

or, except incidentally, the theories which it has promulgated. It will be sufficient, therefore, to say that it is fortunate that there are not many cases heard by the Commission which have been decided strictly on the basis of sectional or class interests, altho there are several cases in which the strong claims put forth in behalf of certain communities or certain classes of persons have received a degree of recognition.

1. *Domestic Versus Foreign Producers*

Perhaps the best example of this form of discrimination, at least the one which will excite the least criticism, is where the Commission has undertaken to assist the domestic producer at the expense of the foreigner. A good illustration is afforded by the case of *The National Hay Association v. The Lake Shore and Michigan Southern Railway Company et al.*[1] Prior to the passage of the Dingley Tariff Act in 1897 hay from Canada had competed actively with hay from the Middle West in the eastern markets of the United States. At this time the rates on Canadian hay under the Official Classification adopted by the eastern trunk lines were commodity rates lower than fifth-class rates while hay from the Middle West paid sixth-class rates. In order to protect the domestic producer of hay the Dingley Tariff Act increased the tariff on hay coming from foreign countries from two dollars to four dollars a ton. This increase in the tariff rate checked the importation of hay from Canada, tho it did not actually prevent it.

On January 1, 1900, the roads operating under the Official Classification changed the classification of American hay from sixth class to fifth class with a

[1] 9 I. C. C. Rep. 264.

corresponding increase of rates, but left the commodity rates on Canadian hay as they had been. Under this readjustment of rates the importation of Canadian hay rapidly increased and the competition was proving a hindrance to the American producer. The roads gave as reasons for the change in rates cost of service and need of more revenue, neither of which arguments the Commission was inclined to recognize. On the other hand, the Commissioners called attention to the fact that the advance in rates had in reality thwarted the purpose of Congress in increasing the tariff on Canadian hay. They said: —

> That advance interfered with a long standing relation of charges from the two producing sections which operated to give an advantage to Canadian hay compared with the pre-existing situation, and such change in a long existing rate adjustment was in favor of a producing section in an adjacent foreign country from which hay shipments into the United States are required by law to pay a duty as great as $4 per ton.

The effect of the Commission's decision was, of course, to favor the producer of hay in the Middle West against not only the Canadian producer but also the eastern consumer. Whatever our ideas may be as to the necessity or desirability of a tariff on hay, we shall all probably agree that the Commission was bound to reach a decision which did not interfere with the interests of the nation at large as those interests had been interpreted by the Dingley Tariff Act.

2. *Vested Interests*

Less justifiable to the present writer appear to be those cases in which the Commission has by its decisions upheld existing methods of production or distribution in which certain sections or certain classes of pro-

ducers have appeared to have a particular interest at the expense of new and cheaper methods which were coming into use. Probably the best illustration of this class of cases comes from the cotton traffic.[1]

By the method commonly employed throughout the South, cotton after being ginned at the plantation gin is made into a square bale having a density of about 12½ pounds to the cubic foot. The rates are the same per 100 pounds for this uncompressed cotton as they are for cotton which has been further compressed. But before cotton is carried long distances it is usually taken by the carrier to a compress situated on the route, and frequently owned by the railroad, and the plantation bales are further compressed until the average bale has a density of about 23 pounds per cubic foot. When compressed in this way about 25,000 pounds of cotton can be conveniently carried in a single car.

For some years prior to the bringing of the complaint there had been coming into use a new method of compressing cotton into round bales by means of a patent device belonging to the complainant. The device was relatively inexpensive, costing from $3500 to $4000 each, and could be used in connection with the plantation or neighborhood gin. Cotton when compressed by this method has a density of about 45 to 47 pounds per cubic foot and about 45,000 pounds can be shipped in a single car load. When compressed by this method immediately after ginning it is in condition to be shipped to its final destination. It has been shown that cotton compressed by this method is in better condition when it reaches the

[1] Planters' Compress Company v. C. C. C. & St. L. R'y. Co. et al., 11 I. C. C. Rep. 382.

manufacturer and is more in demand than when baled by the usual methods.[1]

Owing to the fact that a much larger quantity of cotton in round bales could be shipped in a single car load than when it was sent in the old-fashioned square bales, the carriers made defendants in the case had for two years prior to 1900 given a net rate of 20 cents per 100 pounds to the cotton compressed by the complainant's process, while at the same time cotton in square bales had been charged a rate of 30 cents per 100 pounds. The complainant asked that this adjustment of rates be continued. It was shown that steamship companies exporting cotton granted lower rates on round-bale cotton than on cotton baled in the ordinary way. "This," acknowledged the Commission, "is because its greater density permits a greater weight to be loaded in the same space, and perhaps to some extent because it is easier to handle."

In spite of the obvious advantages of transporting cotton in the more compact bales, the majority of the Commission were opposed to granting lower rates to car load shipments of 45,000 pounds or more than were granted to car load shipments with 25,000 pounds as the average car load. The reasons for the decision were long-standing custom and the fear of monopoly. It was said that to adjust rates in the way asked for by the complainant would encourage the use of complainant's device throughout the South in order to get the benefits of the lower rates. This in turn would result in having cotton compressed at the gin houses

[1] See for a discussion of the relative merits of the square and the round bale, H. Hammond, The Handling and Uses of Cotton, in Bulletin No. 33, Office of Experiment Stations, U. S. Dept. of Agric. pp. 360–365; also the present writer's, Cotton Culture and Cotton Trade, Pubs. American Econ. Assoc., New Series, No. 1, pp. 351–355.

and this, thought the majority of the Commissioners, would make difficult the classification of cotton and its separation into different grades. They did not question the contention of the complainant that the costs to the carrier of shipping cotton compressed by the complainant's method were less than when the older method of baling was used, but they claimed that this did not impose upon the carrier "the obligation to recognize this saving of expense by a corresponding reduction of charges." The majority held that the thing of chief importance was to secure reasonable rates on commodities in the form in which they were commonly prepared for transportation, and held that when rates so established were reasonable, the same rates did not become unreasonable to the shipper who preferred to prepare his shipment in a form which might afford the carrier a greater profit per hundred pounds. "To adjust rates on different articles on the basis of comparative cost to the carrier," said the majority report, "would involve a wide departure from accepted theories of rate making: to adjust rates on the same article with reference to cost of carriage under different conditions would be still more radical."

Commissioner Prouty wrote a vigorous dissenting opinion in the case in which he argued for the logical application of the cost of service principle. He openly accused his colleagues of trying to shield themselves behind trivial and irrelevant analogies and of reaching a decision which tended to hinder the course of industry and progress. He declared that car capacity more than any other one thing was generally made use of by the carriers in determining rates and said that the Commission had "repeatedly recognized the substantial accuracy of this position." He de-

clared that he agreed with the complainant that if 30 cents per 100 pounds was a reasonable rate for transporting 25,000 pounds of cotton in a car, then it was entirely unreasonable to apply that rate to a car of 50,000 pounds. The carrier would be compelled to haul two car loads of the square-bale cotton to earn the same amount of money which it received for a car load of round bales.

Taking up the arguments made by the majority, Mr. Prouty discussed the objection made to cost of service as follows: —

> It is said that cost of service is not the test of a reasonable rate. This is undoubtedly true in many cases. There are many instances in which there is no intimate connection between cost of carriage and the rate charged for that carriage. But with respect to a staple commodity like cotton I believe that there should be a very intimate connection between cost of carriage and the rate charged the public, and that if in any way the cost of carriage has been or can be actually reduced one-third, the public should be given the benefit of that reduction.

Mr. Prouty next pointed out what was likely to be the effect of the majority decision on the business of the complainant and on progress in the direction of reducing the costs of marketing the cotton crop.

> The only advantage of the round bale is that it produces a bale of greater density and thereby reduces the actual cost of movement materially. If this advantage in transportation is not recognized, it has no value and cannot come into use. If the railways decline to accord to this form of compression the saving in cost of transportation which it actually makes, or some reasonable part of it, that bale never can be offered for transportation in very large quantity.

Mr. Prouty also pointed out that recognition of the complainant's claim would redound to the advantage of several other owners of devices for making compact bales. So far from creating a monopoly,

it would tend to modify the semi-monopoly which the railroads enjoyed of compressing cotton *en route* in their own compresses.

It has already been noted that it has been the general practice of the carriers, upheld by the Commission, to give the same rates and classification to wheat and to wheat flour. In two cases,[1] however, which have been brought before the Commission that body has upheld the carriers in their practice of charging five cents more per hundred pounds for transporting flour from points in Missouri and Kansas to points in Texas than they charged for carrying wheat from the same points of origin to the same points of destination. The carriers made their defence partly on the basis of differences in the values of the two commodities and partly on differences in the cost of service. The Commission could not sustain these arguments, since they would have been applicable under any circumstances, and it was shown that the same carriers as were made defendants in this case were transporting wheat and flour in other directions at the same rates on both commodities, and such an equalization of rates, as we have just said, has frequently been upheld by the Commission.

The investigations conducted by the Commission in these cases showed that in both instances the five-cent differential rate on wheat had been made for the purpose of protecting the large and growing milling industry of Texas. The Texas mills it was said widened the market for Texas wheat growers but were at a disadvantage compared to St. Louis mills owing to higher costs of fuel, labor, and the like. The de-

[1] Kauffman Milling Co. v. Mo. Pacif. R'y Co. et al. 4 I. C. C. Rep. 417; 3 I. C. R. 400. Mayor and City Council of Wichita, Kansas v. Mo. Pacif. R'y Co. et al., 10 I. C. C. Rep. 35.

fendants claimed that the complainants were not injured by the existence of the differential since they could still compete in the Texas markets. The majority of the Commission decided to uphold the differential in the first of the above cases because of its long continuance; because the milling industry of Texas was in a flourishing condition and had had beneficial effects on raising the price of wheat in Kansas and Missouri as well as in Texas, and because the differential seemed necessary in order "to place the competitive milling interests upon a substantial parity."

Commissioner Morrison dissented from the conclusions of the majority of the Commission in this case. He said that the decision assumed "to put the millers of Texas on a parity with their competitors in the Texas markets, by depriving Missouri and Kansas mills of whatever advantages they have in their favorable location." This he pointed out was in direct conflict with previous decisions of the Commission.

In the second of the above cases the Commission abandoned its contention that the differential on wheat was necessary to maintain competition between Texas mills and those in Kansas and Missouri. On the contrary it declared that "the Commission has no more authority to place competing millers in different states upon precisely the same footing than it has to equalize conditions in all localities and in every industry." It nevertheless upheld the differential on the ground that many new and flourishing mills had recently sprung up in Texas as a result of an accidental crop yield and that to equalize the rates on wheat and flour would handicap these mills in their competition with the Kansas mills. The Commission therefore announced that it must "decline to disturb

relations of rates" since such disturbance "could scarcely fail to be injurious to important vested rights." It also declared that the maintenance of competition between the Texas mills and those in Kansas was a direct benefit to the Kansas farmers in that it tended to raise the price of their grain, and the Commissioners said: "Anything which increases the value of the products of the soil to the producer seems so desirable a result, that if the Commission was endeavoring to adjust the conditions investing various localities, that which led to the prosperity of the agriculturist must receive favorable attention."

Whether one looks at this case from the standpoint of the Texas millers or of the Kansas wheat growers it is apparent that the Commission's decisions were based on the special and peculiar interest of these particular classes of persons.

In spite of the fact that neither Los Angeles nor San Bernardino, California, is situated on the coast, the Commission decided in the case of *A. W. Holdzkom* v. *Michigan Central Railway Company et al.*[1] that the carriers from the East were justified in considering Los Angeles a "terminal point," enjoying the benefits of water transportation from the East and therefore entitled to the same rates as San Francisco received while San Bernardino must continue to pay the through rates to Los Angeles plus the local rates from Los Angeles to San Bernardino. The Commission set forth its reasons for permitting this discrimination as follows: —

In coming to this conclusion we have been largely influenced by the consideration that while this action upon the part of the carriers has certainly worked a preference in favor of Los Angeles as against towns like San Bernardino, it has at the same time bene-

[1] 9 I. C. C. Rep. 42.

fitted southern California as a whole. The result has been to transfer the wholesale business of southern California in so far as it is transacted upon the Pacific Slope, mainly from San Francisco to Los Angeles. Before Los Angeles enjoyed this rate San Francisco jobbers covered that territory. Now they have given place to the jobbers of Los Angeles, and in many instances San Francisco houses have established branches at Los Angeles. It is probable that this arrangement results in somewhat cheaper prices for southern California than would be secured by a distribution from San Francisco, since the cost at the two centers of distribution is now the same, while the expense of distributing from Los Angeles is somewhat less. While, therefore, Los Angeles has been benefitted, it would appear that this whole section shares to an extent in such benefit, nor is it easy to perceive how San Bernardino has been materially injured since that city could not become a jobbing center as against San Francisco under original conditions.

The grounds for the Commission's decision are therefore the interest of southern California as a whole. That the decision, while favorable to the jobbers of Los Angeles and perhaps to the consumers of southern California, was opposed to the interests of San Francisco jobbers was a fact which apparently received little consideration from the Commissioners.

In all the cases which we have considered under the heading of class and sectional interests, the Commission does not seem to have been guided by what it terms "fundamental principles." The cases have been disposed of, as the Commissioners said in the *Kauffman Milling case*, "with a view to what is best for the public interests immediately concerned, and upon facts found to exist rather than upon theories of transportation." Perhaps the most fundamental consideration involved was the desire to preserve competition among producers or producing sections, and this the Commission has undertaken to do even when at times it has been necessary to depart from economic principles and to sacrifice in a measure the interests of the consumers.

VIII. Fair Return on Investment

During recent years there has been an urgent demand on the part of many writers and public officials that the Federal government attempt to make a valuation of the physical property of the railroads of the United States and that it also take steps to control the further issue of railway securities. This demand, representing what Professor Adams calls "the public interest in the property accounts of railways," as opposed to the interest of the railway management and the interest of the investor, "rests upon the fact that a reasonable rate for transportation services is a rate which contributes a reasonable return upon necessary investments." [1]

The argument for a physical valuation of railway property and a limitation of railway securities may be briefly stated as follows. The railways are common carriers, concerned in the business of performing a service essentially public in character. Their corporate existence is furthermore due to franchises granted by the public authorities. In the performance of a public service their owners are not entitled to charge more than a fair return upon the actual capital invested and this can only be known when the value of the property has been ascertained. In the future the issues of railway securities should be made to correspond to the actual investment of capital. Rates in general can then be so regulated as to yield only normal rates on the capital investments and on the par value of the new stock issues.

[1] Twenty-first Annual Report on the Statistics of Railways in the United States (1908), p. 11.

1. *Development of the Theory*

This theory of rate making received but little attention during the early years of the existence of the Interstate Commerce Commission. It was, however, not entirely overlooked; it was dealt with, tho in a purely incidental way, in some of the earlier decisions. Thus in one case [1] where the complainants had urged that the defendant's rates on wheat were too high when compared to rates on the same commodity charged by other roads, and the defendant had pleaded as an excuse the high cost of constructing and maintaining the road and the low rate of return on its paid-up stock, the Commissioners had replied that the roads with which the complainant had made comparison

> have a greater variety of local and way freights, and are not compelled to depend, as is the defendant, so largely upon what they receive for the transportation of any one local commodity, such as wheat. They, therefore, derive revenue from these other sources of local and way freights to a much greater extent than the defendant, and can with confidence rely upon them, and for this reason alone can safely make their rates less than the defendant.

A more significant utterance appears in the Commission's report on *Alleged Excessive Freight Rates and Charges on Food Products.*[2] The shippers had advanced the claim that the railway rates from the West should be so adjusted as to enable farm produce to be sold in the East at a profit. The Commissioners could not admit that the railroads were bound so to adjust their rates that "shippers may in all cases realize actual cost of production." Such a basis of

[1] Milton Evans et al. v. The Oregon Railway and Navigation Co., 1 I. C. C. Rep. 325.

[2] 4 I. C. C. Rep. 48; 3 I. C. R. 93.

rate making they said "will hardly stand the test of fair dealing. It would compel those who invest in or operate railroads to assume and bear the losses resulting from the improvidence, mismanagement, or unprofitable employment of others." At the same time the Commissioners declared that the roads should offer such rates, if they are "fairly remunerative," as would encourage and warrant the movement of commodities and such a rule was particularly applicable to the staple agricultural commodities. The Commission was careful to state that in deciding what rates were "fairly remunerative" it must not be implied that a dividend on watered stock was to be included, and they laid down this further principle:—

In fixing reasonable rates the requirements of operating expenses, bonded debt, fixed charges, and dividends on capital stock from the total traffic are all to be considered, but the claim that any particular rate is to be measured by them as a fixed standard, below which the rate may not lawfully be reduced, is one rightfully subject to some qualifications, one of which is the obligations must be actual and in good faith.

Another limitation on the principle of fair remuneration is stated in one of the Standard Oil cases [1] where it is said that a carrier

may establish its rates to yield fair remuneration for its services, subject to prescribed limitations, but it may not treat every division of its system serving a common territory as an independent property, and vary its rates to suit the conditions of each piece of property, and thereby arbitrarily exact charges that make a profitable market for one portion of its patrons and that exclude others similarly situated from the same market.

The limited use which the Commission made of the principle that rates must be so limited as to yield only normal returns on investment during the early

[1] Rice, Robinson & Wintherop v. The Western New York and Pennsylvania R. R. Co., 4 I. C. C. Rep. 131; 3 I. C. R. 162.

years of its existence doubtless finds its chief explanation in the fact that nearly all of the earlier decisions had to do with rates on particular commodities rather than with an entire schedule of rates. Altho, as we shall see, the Commission has made a limited use of this principle in dealing with rates on a few important commodities, it has never been seriously urged by members of the Commission or others that this theory of rate making could be rigidly applied to determine what was a reasonable rate on a specific commodity carried a specific distance. The principle has found its widest application in those cases in which the Commission has had to consider the question as to whether or not a general advance in rates, or at least an advance on an entire class of commodities, by a single railway system or by several railroads acting in conjunction, was legitimate.

2. *Rates in general*

In seeking to make use of the principle that a reasonable rate is one that yields a fair return on capital actually invested, the Commission has been greatly handicapped by the fact that there has never been furnished to it any authoritative statement as to what is the actual capital investment of our railroads, either singly or in the aggregate, or as to what constitutes a reasonable rate of return on this capital. The United States Supreme Court in the *Nebraska Freight Rate case* [1] established the rule that a carrier is entitled to earn a "fair return upon the value of that which it employs for the public convenience," but this, in the absence of any standard for determining what is that value, is, as the Commission

[1] 169 U. S. 466.

says,[1] much like reasoning in a circle, since the value of a railway's property is in large part dependent on the rates which it is permitted to charge. The Commission expressed the opinion in this case that the cost of reproducing a railway's property could not well be made a test as to the value of the investment, tho it might furnish some assistance in determining that value. Even this standard of measurement is lacking, and the Commission stated the difficulties which it confronts in seeking to determine what constitutes a reasonable rate schedule in these words:—

It is plain that until there be fixed either by legislative enactment or judicial interpretation, some definite basis for the valuation of railway property and some limit up to which that property shall be allowed to earn upon that valuation, there can be no exact determination of these questions.

In the absence of such official standards the Commission in seeking to judge as to the reasonableness of a proposed general advance in rates has thrown upon the railroads the burden of proving that they were not prospering under existing rates. The most notable decisions of this sort were handed down only a few months ago and are still fresh in our minds; but the principles upon which the Commissioners acted in refusing to allow the recent proposed advances in freight rates are not new and need have caused no surprise to those who have followed the Commission's line of reasoning in earlier cases. In the case which we have just been considering the carriers had declared that rates had been reduced in bad times; the prices of materials and labor had risen with the return of prosperity; the roads hence were entitled to raise their rates. The Commission itself has so

[1] Proposed Advances in Freight Rates, 9 I. C. C. Rep. 382.

succinctly stated the argument of the carriers that its words deserve to be quoted.

> The present prices of commodities are high, therefore they can pay a higher freight charge. Times are good and railroads should share in the general prosperity; but high prices of materials and labor add to the expense of operation and gross revenues must therefore be increased.

This argument, it will be observed, is a combination of cost of service and of value of service, or "charging what the traffic will bear" arguments. So far as the cost of service argument is concerned its validity would of course depend on the evidence as to increased costs submitted by the carriers. If value of service is, however, to be made the test, and if any meaning is to be given to this elusive term, it is hard to see why the carriers' argument is not conclusive. For in times of prosperity and high prices the railroads certainly do by means of the transportation of commodities increase the value of service both to producers and consumers. We have already seen [1] that the Commissioners permitted the increase in rates to be made in the case of iron and steel on the ground that the rates on these commodities had been reduced because of business depression.

With reference to other commodities, particularly grain, the Commission shifted its ground. It declared that it was not called upon to consider alone the question as to whether the proposed rate was reasonable when "estimated by the cost and value of the service, and as compared with other commodities," but that it must decide whether the rate was "reasonable in the absolute, regarded more nearly as a tax laid upon the people who ultimately pay that rate." This statement might seem to introduce into the Com-

[1] Quarterly Journal of Economics, November, 1910, vol. xxv., p. 36.

mission's decisions a new theory of rate making, viz. the tax principle so much emphasized by Professor Cohn.[1] That this was not the intention of the Commissioners, however, is shown by their further statement that every inquiry into the reasonableness of a given rate "involves the idea of some limit beyond which the capital invested in railways ought not to be allowed to tax other species of property."

While the Commissioners could not, in the absence of any judicial or legislative standard, declare just what the limit should be, they applied this apparently negative conclusion to the case under discussion in the following manner. The statistics of earnings and expenses of the leading lines covered by the investigation showed that these roads had shared in the general prosperity of the country simply by an increase of their traffic. Railway transportation being subject to the law of increasing returns, this increase of traffic had caused an increase in the net earnings of the roads. The investigation further showed that rates in general, and on grain in particular, had not been reduced during the period of financial depression. The Commission therefore held that rates long established, which had been fixed by competition and were fairly remunerative, could not be advanced merely in order that in this way the railroads might share in the prosperity of the country.

The report of an investigation made by the Commission *In the Matter of Class and Commodity Rates from St. Louis to Texas Common Points, etc.*[2] is in many respects analogous to the case we have just

[1] G. Cohn, Die englische Eisenbahn Politik der letzten zehn Jahre, pp. 65–84. For a discussion of Cohn's theory see Professor Taussig's Contribution to the Theory of Railway Rates, Quarterly Journal of Economics, vol. v., pp. 438–465.

[2] 11 I. C. C. Rep. 238.

considered. The roads in the Southwest had announced an increase in rates and gave as their reasons for the advance: (1) an increase in " the cost of labor, materials, and everything which enters into the construction and operation of a railroad "; (2) an increase in the prosperity of the country, in which it was said the railroads were entitled to share. As a proof of the increase in prices the railroads offered a comparison between prices paid in 1903 and those paid in 1897, to which the Commission made answer: —

It is evident that a comparison between the panic prices of 1897 and the inflated prices of 1903 would produce startling results of this nature and it is equally evident that such comparisons are utterly worthless for determining a legitimate basis for freight rates.

The Commission instituted an investigation of its own into the relative prices paid by the railroads for steel rails, equipment, fuel, and labor in the years 1892, 1896, 1902, and 1903 and concluded that " the total cost of moving a ton of freight one mile upon the lines of these respondents as a whole was probably as low in 1903 as it had ever been."

In answer to the claim of the carriers that they should share in the prosperity of the country the Commissioners replied: —

To the proposition that the railroads of this country are entitled to share in the prosperous conditions of the present we entirely assent. . . . When the claims of these respondents are carefully examined that is not at all the thing for which they contend, but rather that because the prices of the commodities which they transport have advanced the rate of transportation should also be advanced. To that we do not assent. The freight rate is not a commodity the price of which should ordinarily vary with the price of the commodities which are transported. A railroad may not advance its passenger fares simply because the people who ride are making more money. The question is rather whether the fare charged allows the carrier a fair return for its services.

The Commissioners admit that if the roads reduce a rate to enable a manufacturer to continue in business during a business depression "there is no reason why with the return of prosperity the rate should not be restored," but this was not the case with the advance announced. To show how illogical was the argument that the announced increase of rates was justified by the increase of prosperity the Commission quotes the argument of the representative of one of the roads that owing to the ravages of the boll-weevil in Texas his road did not get the usual amount of cotton for transportation and,

> *for these reasons it had become necessary to advance rates in order to obtain sufficient revenue with which to operate the road and pay a fair return upon the investment.* Here, therefore, we have in the same case and by parties of the same general system a claim upon the one hand that these advances are justified by general conditions of prosperity and upon the other hand that they are justified by general conditions of adversity.

The way in which the roads should share in the prosperity of the country the Commission then proceeds to indicate.

> Railroads should share in the general prosperity. They should do this partly by being able to advance those rates which have declined under commercial conditions. They should do it still more by the increased traffic which they obtain. In times of prosperity when money is plenty and business is good people ride more, buy more, new industries are being established and old industries are active, traffic increases and out of such increased traffic the railway obtains, by automatic action so to speak, without any advance in its rate a large share in the general prosperity.

Declining to admit, therefore, that the proposed advance was to be justified either by cost of service arguments or by increases in the values of the commodities transported, the Commission turned to the question as to whether the rates charged before the

advance was made were sufficient to allow the carrier a fair return for the services rendered. The statistics as to cost of reproducing the property and as to the increase in gross and net earnings between 1892 and 1903 showed on the whole favorable conditions. Most of the roads were shown to be earning six per cent or more on the cost of reproducing the property. The Commission nevertheless hesitated to issue an order for a restoration of rates to their former level, their hesitation being due to the fact that in spite of improved conditions the earning power of these roads was still below that of the roads in other parts of the country.

The final test is the actual result of actual operations and it cannot be denied that the financial showing of these respondents, especially those roads which operate in the state of Texas, is not favorable. The railroads embraced in this discussion are mainly confined to Groups VIII and IX [of the Commission's classification]. If these groups are combined and treated as one, the average net earnings per mile are much lower than those in any other group in the United States. The percentage of cost of operation to gross revenue is larger than in any other group in the United States. While many of these respondents are yielding a munificent return upon any fair basis of valuation, and while most of them are earning six per cent, at least upon the cost of reproducing the properties today, nevertheless it is true that many of them do not now and have not for years paid dividends to their stockholders. This is partly due to the fact of over capitalization and partly, perhaps, to the peculiar state of the law in Texas, which as applied to these railroads virtually requires that the net earnings be retained in the property, as previously explained. But in any view of the matter the fact cannot be overlooked that those Texas lines as compared with other roads in this country are poor.

While firmly convinced that the advances had been due to rate agreements among the carriers, the Commissioners concluded that a general reduction ought not to be ordered "unless it is perfectly clear that the rates in effect are unreasonable."

The statement just quoted from the Commission's decision that the rates might be too low since some of the roads had been unable to pay dividends on stock which was at least in part "water," might lead one to suppose that the Commission was ready to concede the right of a road to earn dividends on watered stock as well as on capital actually invested. We have already seen [1] that this is not the case. Additional proof, however, is furnished by two other cases [2] which have come before the Commission in which the plea was made that if rates were reduced the carriers would be unable to pay dividends. The answer of the Commission was practically the same in both cases. In the Danville case they said concerning the common stock of the defendant carrier: —

> It does not appear that the persons to whom this stock was originally issued ever paid one dollar in actual value for it. It simply appears that the stock is out-standing. This is not enough. Something more is needed when a claim of this kind is set up than the mere fact of the existence and amount of capitalization.

The Commission has, however, gone farther than merely to hold that there is no obligation on the part of carriers to maintain high rates in order to pay dividends on stock which represents no real investment. In at least one case [3] it has put itself on record to the effect that railway managers who have made unwise ventures are not entitled to exact unreasonably high charges from shippers in order that their roads may become profitable investments. The defendant in this case sought to justify a greater charge for a short haul than for a long haul on the ground that com-

[1] Above, p. 517.

[2] Grain Shippers' Association of Northwest Iowa v. Ill. Cent. R. R. Co., 8 I. C. C. Rep. 158. City of Danville v. Southern R'y Co., 8 I. C. C. Rep. 571.

[3] Cary v. Eureka Springs R'y Co., 7 I. C. C. Rep. 286.

petition necessitated a low rate for the long haul, while if the rate for the short haul were made equally low the earnings of the carrier would be insufficient to yield a fair return on the capital investment. The financial statements of the road for several years past were submitted in proof of this statement. The Commission had no authority to prescribe a rate for the future owing to the decision of the United States Supreme Court to that effect.[2] It nevertheless recommended a reduction of the short haul rate in this case and said: —

> That transportation charges should be liberal until the earnings are fully sufficient for a fair return on actual investment will hardly be questioned, but it does not follow that rates long maintained and grossly discriminative must be continued and may be lawfully exacted year by year, tho it be assumed that railroad investment of property is so much more inviolable than other property that its owners must bear none of the losses or disadvantages incident to industrial and financial disarrangement, and that transportation charges are never excessive when the annual net earnings are less than the amount necessary to the reasonable annual income on such property and investment.

So far as a general schedule of rates is concerned, therefore, it may be said to be the opinion of the Commission that these rates may be only high enough to earn a fair return upon a *legitimate* investment of capital in the construction and operation of the road.

3. *Particular Rates*

A charge made for hauling a particular commodity or for the performance of a specific service may not properly be judged by the same standard as is applied to an entire rate schedule. Some rates need to be lower, while others may properly be higher than the

[2] Maximum Rate Case. 167 U. S. 479.

average rate needed to yield a fair return upon the capital investment. In the case of the *Central Yellow Pine Association v. The Illinois Central Railroad et al.*,[1] the Commission has well explained why in measuring the reasonableness of a rate on a given commodity different standards must be applied than are used to measure the reasonableness of an entire system of rates.

The defendants had attempted to justify an advance in the rates on lumber shipped from points in the southern states to places on the Ohio river and beyond, partly on the ground of an increase in costs of operation, but mainly on the ground that "lumber, considering its character and the conditions attending its transportation, was not yielding its proportion of the revenue required by the defendants to meet their expenses."

To this argument the Commission replied: —

The question of the reasonableness in this sense of a rate *on a single article* of traffic is one of almost insuperable difficulty. . . . The value of the entire property of a road employed for the public convenience can shed but little, if any light upon the question whether the rate on a single one among thousands of articles of traffic yields its proper proportion of a fair return on that value. The rate on one article of traffic may be reasonably high and the carrier fail to earn a fair return on the value of the entire property employed for the public convenience because of unreasonably low rates on other traffic, and *vice versa,* the rate on one article of traffic may be unremunerative or unreasonably low and the return to the carriers from its entire business may be fair or reasonably high, the deficiency under the rate on one article of traffic being made up by the rates on the balance of the traffic. . . . While the Supreme Court has undertaken to point out "certain elements" to be considered in determining the reasonableness of an entire system of rates, it has not named any as shedding light upon the reasonableness of a rate on a single commodity like lumber. It is evident that such elements are widely variant in the two cases. Where an entire system of rates is involved,

[1] 10 I. C. C. Rep. 505.

the principal, if not the only question, is whether the revenue yielded by the rates on all traffic is a "fair return on the value of that which is employed for the public convenience" — a question, the determination of which, — as we have shown, can have only a very remote, if any, practical bearing on the reasonableness of a rate on a single article of traffic. On the other hand, where the rate on a single article is in issue, the question (which could not arise in the former case) whether the rate is unjustly discriminatory or unduly preferential, may be presented, and the reasonableness of the rate depends upon the value, volume and other characteristics affecting the transportation of the particular commodity to which it is applied.

In the present case the majority of the Commission decided that neither the increase in the cost of operating the roads, nor the carriers' need for increased revenues, nor yet the increased prosperity of the lumber manufacturers, warranted the increase of rates. The advance in rates was due to concert of action between the carriers and this concert of action had eliminated competition. The Commission held that the rates should be restored to the level at which competition had left them.

Practically the same arguments were advanced and the same conclusions reached in another lumber case, that of *H. H. Tift et al. v. Southern Railway Company et al.*[1] The same principle is also expressed, tho perhaps less clearly, in several of the earlier decisions.[2]

The Commission has given weight, however, to the argument that need of revenue may justify a carrier in maintaining discriminatingly high rates under certain exceptional circumstances. Certain of the southern states have within recent years established uniform passenger rates of 3 cents a mile on the roads

[1] 10 I. C. C. Rep. 548.

[2] See for example Jerome Hill Cotton Co. v. M. K. & T. R. R. Co., 6 I. C. C. Rep. 601. Brewer & Hanleiter v. L. & N. R. R. Co., 7 I. C. C. Rep. 224.

within their borders. The roads have protested against lowering their interstate rates to the same figure, claiming that to do so would reduce their revenues to such a point as to yield them less than a fair return on their investment. Very reluctantly the Commission has permitted, in some instances, the higher interstate rates to remain in force. In one [1] of the cases the Commission said: —

> A reduction of this interstate passenger fare would not contribute to the development of the section or increase materially the passenger business of the line. Reducing the fare to three cents per mile would render the earnings of this part of the system less than the average upon the whole system and less than the average of other roads in that part of the country.

In another case [2] where the Commission decided that the interstate rate complained of was not unreasonable the Commission added: "What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

Of more significance, however, is the Commission's statement in the case of *Board of Trade of the City of Hampton, Florida v. Nashville, Chattanooga & St. Louis Railway Company* [3] where financial necessity was made one of the excuses by the defendant for accepting rates at competitive points which did little more than cover the operating expenses and which could therefore not be extended to non-competitive points. The Commission replied: —

> Rates cannot be said to be reasonable which are not reasonably remunerative to the carrier, and rates which do not pay their full proportion of operating expenses, fixed charges and reasonable dividends are not *per se*, or in and of themselves, reasonably re-

[1] A. L. Artz v. Seaboard Air Line Railway, 11 I. C. C. Rep. 458.

[2] R. C. Brabham et al. v. Atlantic Coast Line R'y et al., 11 I. C. C. Rep. 464.

[3] 8 I. C. C. Rep. 503.

munerative. While it may be that carriers, under certain exceptional conditions, are justified in accepting rates which pay anything in excess of operating expenses or the cost of movement, yet as a general rule all traffic should be made, if possible, to pay its due proportion of operating expenses, fixed charges and reasonable dividends.

It may then be held to be the well-established opinion of the Interstate Commerce Commission, as well as of the courts, that the test to be applied to determine the reasonableness of an entire system of rates is whether these rates yield only a "fair return on the value of that which is employed for the public convenience." Much still remains to be done in the way of measuring that value, but the Commission at any rate is clearly inclined to the opinion that it must include only *bona fide* investments of capital. Tho the same test cannot be applied with the same degree of accuracy in the case of particular rates, the principle may be said even here to have found recognition that unless exceptional conditions prevail, a particular rate must be so arranged as to cover the commodity's "due proportion of operating expenses, fixed charges, and reasonable dividends."

IX. General Summary and Conclusions

We have attempted in the course of these papers to set forth as fully as space would permit the theories of the Interstate Commerce Commission concerning the bases of railway charges. These views have been enunciated in the course of many decisions rendered during a period covering two decades. Since the membership of the Commission has been changing in the meantime, the theories do not always represent the changing views of the same individuals. In spite of the obvious difficulty in attempting to re-

state and classify other men's opinions, it is believed that the preceding discussion, in which the fundamental principles in each case have been given as frequently as possible in the Commission's own words, has not greatly misrepresented or exaggerated the views of that body.

We must now attempt such an interpretation of the Commission's views as shall show how the leading principles revealed by our classification may be in a large measure harmonized and reduced to their lowest terms. If this can be done in a satisfactory manner we shall be able to indicate the tendencies which are likely to be followed in our system of government-regulated railway rates in future years. It is perhaps unnecessary to say that the members of the Commission must in no degree be held liable for this interpretation. The present writer assumes full responsibility.

The Commission began its work with the idea that *value of service* was the underlying principle of railway rates. It was unable, however, to furnish such a precise definition or explanation of this term as would enable it to be used as a concrete measure of a reasonable rate. How uncertain is the meaning of the phrase and how different may be the interpretation of it given by the railway manager from that which the Commission clearly had in mind is shown by the use made of it to defend the rate on cotton charged by one of our southwestern roads.[1] The vice-president of the road had stated before the Commission that the rate in question had been made in accordance with the principle of "the value of the service." Upon being asked to explain the method of applying the principle in this case, he replied that two rules had been followed by his company: (1) "to give

[1] Jerome Hill Cotton Co. v. M. K. & T. R. R. Co., 6 I. C. C. Rep. 601.

[secure] the largest revenue the traffic will bear"; (2) "to find a market for the stuff." Keeping both these principles in mind, he declared that "any rate is reasonable under which traffic will move absolutely. It all moves out every season. If it moves out, it must be a reasonable rate."

If this pragmatic explanation of what constitutes a reasonable rate be accepted as a fair indication of what we may expect when rates are fixed according to value of service, it is plain that we shall find that value of service is merely equivalent to the well-known monopolistic principle of charging that price which will yield the highest net return. It is also evident that the Interstate Commerce Commission could never consent to the use of such a principle as a basis for determining reasonable rates.

The great advantage which *cost of service* has over value of service is that it furnishes a concrete standard of measurement. It states a *quid pro quo* as a reason for making the charge. It is the standard of reasonableness which has been adopted in all our economic relations. To make charges less than costs would mean that other commodities or other industries would have to make up the deficiency, or else the railroads of the country would run at a loss. To charge more than costs, on the other hand, would mean that the railway industry was forcing other industries to surrender to it a portion of their legitimate earnings. The fact that it is universally accepted in other transactions as a test of reasonableness explains why the Commission has naturally turned to a consideration of costs when the equity of a given rate has been brought in question, and it also explains why railway officials have naturally made cost of service their defence whenever their rates have been attacked.

At the outset of its labors the Commission was not inclined to place much confidence in cost of service as a principle for determining rates. The feeling that rates fixed in this way would prevent the free movement of certain commodities explains in part the attitude of the Commissioners, but the main objection has seemed to be the practical impossibility of determining the exact cost of transporting a particular commodity. That there are obstacles — insuperable ones — to any direct determination of the costs of performing a specific service in transportation no one familiar with the subject would deny. It has not been by means of a direct determination of the costs, however, that the Commission has sought a solution. The method followed, as we have seen, has been that of comparison. The ascertainable costs of moving a certain commodity have been compared with the costs of moving the same commodity in a different manner or under different circumstances. The method of *comparative costs* does not yield absolutely accurate results but it is oftentimes sufficient for practical purposes and we must remember that economics, like law, does not concern itself with trifles.

The method of comparative costs has not always been applicable however. The Commission has then been confronted with the task of discovering some other means of measuring rates which would yield the same results as would be attained by a comparison of costs, were that method practicable. In some cases, as we have seen, *distance* may be used as a means of measuring the reasonableness of rates. Considered as the sole element in the determination of rates distance would of course yield unsatisfactory results; but it is nevertheless, as the Commission says, "in the absence of other influences a controlling

element." Its value as a measuring instrument lies not in the fact that it is independent of costs but that in the absence of other influences it reflects costs.

The same thing may be said of the effort of the Commission to preserve for a place its *natural advantages of location.* A place can have no advantage of location which a carrier is bound to respect other than that which is due to its ability to place its products on the market at less cost than can its competitors. Rates based on the principle of recognizing natural advantages of location are therefore true to the cost of service principle.

Even in the absence of these indirect methods of determining costs, the Commission has found it possible to reach the same goal by other methods. It is a fundamental principle of economics that free and untrammeled *competition,* operating over a long period of time, tends to reduce prices to a cost basis. We have therefore only to apply this principle to railway rates to see that rates which have been fixed by competition, provided that this competition has been of a normal sort, will be the same as they would be if all the costs of service had been calculated and rates had then been based on costs. In spite of all the inconsistencies and contradictions involved in the Commission's discussion of competition, — many of which, as we have observed, are due to an effort to preserve the spirit of the law, — we see running throughout the Commission's decisions a tendency to fix rates at the point where a normal and healthy struggle between competing interests has tended to leave them. Competitive rates are therefore true to a cost of service principle.

One other alternative has been presented to the Commission in certain cases where it has been unable

to calculate the costs of service and this, too, has been in accordance with well-known economic principles. What the economist always means by *cost price,* is that price which covers not only actual expenditures made in production but which also leaves a *normal rate of return upon all the capital invested.* In those cases, therefore, in which the Commission has been called upon to deal with a whole system of rates; where it would have been clearly impossible to have calculated all the costs; where even the comparative method was lacking because the increase of rates had been made general, and where competition was not present, — it has still been possible to ask whether these rates have yielded the same results, measured by their effect on earning power, as would have resulted if the cost of service principle had been applied.

In accepting different methods of measuring the reasonableness of railway rates the Interstate Commerce Commission has been confronted with the same difficulty that we find when we come to measure the size or magnitude of physical objects, and it has solved the problem in the same way. In some cases we use dry measure, in others liquid measure, in others cubic measure, and in still others measure by weight. In the metric system, the fundamental unit is the metre, but for practical purposes it is often convenient to use as the unit of measurement the litre or the gram, both of which are, however, based upon the metre. In the same way the Commission in its efforts to base rates upon cost of service has found it practically advantageous at times to use other methods of measurement, — distance, advantage of location, competition, fair return on investment; all of which in the sense in which they are employed by the Commission are merely expressive of cost relations.

Two other considerations emphasized by the Commission, value of commodity, and sectional or class interests, still remain to be dealt with. With reference to the last-named consideration it is hard to see how it can be made to fit in with any defensible theory of railway rates. Possibly the decisions rendered in most of the cases coming under this head are entitled to a degree of justification on the ground that the Commission was endeavoring to preserve competition among producers. Many of the cases in which value of commodity was made the basis of the Commission's decision might easily have been grouped under the heading of cost of service. This is because differences in rates, measured by differences in values of commodities, were allowed because the carrier was assumed to have accepted greater risks in transporting the more valuable commodities. In other cases where low rates were prescribed for low-grade commodities, for example such articles as are usually given commodity rates, it is obvious that the low rates could have been justified as easily on the principle that the costs of moving these commodities were low as on the basis of their low values. If the carriers had been able to show that it actually cost more to move a commodity having a low value than it did to transport one having a higher value it is doubtful if the Commission would ever have insisted that the less valuable commodity should receive the lower rate. In many cases we have observed that the values of commodities were allowed to affect rates because the Commission felt under obligation to maintain competition between establishments located at different points and engaged in turning out products in different stages of manufacture. Here again it is often possible to trace, indirectly through competition, a relation between

the value of the commodity and the cost of transporting it. It is of course not pretended that all cases in which value of commodity is selected as the basis of rate making can thus be brought under the cost of service principle.

If the conclusion be accepted, which these articles seem to support, that the tendency of the Interstate Commerce Commission's decisions is, on the whole, towards a cost of service theory of rate making,[1] there still remains the task of so stating a theory of rates as to bring in the various considerations which we have seen the Commission has emphasized as factors in rate making, and show how they can be related to the fundamental principle. It is perhaps well to say that nowhere has the Commission undertaken to state such a comprehensive theory of rate making.

1. In any system of government-made or government-regulated railway rates, it would seem that this fundamental economic principle should be kept

[1] These articles do not profess to discuss the decisions of the Commission since the Hepburn Act became operative or to consider the theories of other writers. It seems worth while, however, to call attention to the fact that a consideration of the later decisions of the Commission and especially its decision in the recent "advances in rates" investigation in western trunk line territory would do much to strengthen the idea that the Commission was tending towards a cost of service theory. Several books and articles by recent writers also tend to support the argument that cost of service is both practicable and desirable as a basis of railway charges. See especially the article by Commissioner Halford Erickson of the Wisconsin Railway Commission explaining the methods followed by that Commission; The Basis of Reasonable Railway Rates, Publications of the American Economic Association, Third Series, vol. ix (1908), pp. 95–102. See also Standards of Reasonableness in Local Freight Discriminations by Professor John M. Clark of Amherst College in Columbia University Studies in History, Economics and Public Law, vol. xxxvii, no. 1; also Professor M. H. Robinson's articles on Railway Passenger Rates and Railway Freight Rates, Yale Review, vol. xvi, pp. 355–399; vol. xvii, pp. 121–153. Professor Robinson believes that there is a tendency towards the fixing of rates on the basis of costs determined by a scientific and elaborate system of cost-keeping, but points out that at present this is not practicable owing to the unscientific character of railway accounts. It may be said that rates on the eastern trunk lines have for some years been fixed in accordance with a cost of service theory. See Professor Ripley's article, The Trunk Line Rate System: A Distance Tariff, Quarterly Journal of Economics, vol. xx (1906), pp. 183–210; reprinted in Ripley's Railway Problems, pp. 309–332. See also Johnson and Huebner, Railroad Traffic and Rates, vol. i, ch. xxi, and McPherson, Railroad Freight Rates, pp. 70–78.

in mind: to perform the service of transporting persons and goods with the least possible expenditure of social energy.

2. One transportation route or one transportation system should never be allowed to take from another route or system, merely as a consequence of competition, traffic which the latter route or system can carry at less expense.

3. Rates should be so adjusted as never to take from a place its natural geographical advantages of location; but natural advantages should not be so construed as to mean monopoly privileges.

4. Railway rates as a whole should just cover costs as a whole, allowing for a normal rate of return on capital actually invested, a normal return for labor of all sorts, and for depreciation, but not for betterments. This would not mean that superior efficiency in railway management was not entitled to reap the rewards of its superiority in the same way it does in the ordinary industrial establishment where competition rules. On the other hand, the rule must not be construed to mean that any investment in a railroad, no matter how foolishly or recklessly made, is entitled to exact high rates from persons and industries along the line in order to earn current interest rates or dividends. Railway property is not more sacred than other property, nor are railway investors immune from the consequences of their own acts.

5. Each commodity transported should, as far as possible, be made to defray its own share not only of operating and terminal costs but also of the fixed costs and dividends. It is possible under modern accounting methods to determine these costs with an approximate degree of accuracy for the principal

commodities and classes of traffic. The rates on other commodities may be determined by comparing their ascertainable costs with those of the principal commodities, and to a lesser extent by a comparison of the relative values of the commodities.

6. Differences in distance may be made a test of the reasonableness of differences in rates where other conditions appear to be similar; yet the general rule must be kept in mind that tho the aggregate charge should increase as distance increases, the ton-mile rate should decrease.

7. Where the application of none of the above principles seems practicable, competition, which has been conducted in a normal manner over a period of several years, may be assumed to have established a fair relation of rates.

8. A reasonable rate is one which yields a reasonable compensation for the service rendered. If a given rate is reasonable in this sense, an increase in the price of the commodity or in the profits to the producer will not be a valid excuse for increasing the railway rate. The carrier will justly share in the increased prosperity of the producer by securing a larger traffic in this commodity.

The possibility of applying these rules to the business of railway transportation is proved by the fact that the application of every one of them can be shown by illustrations taken from the Commission's decisions. Their consistent application would mean that the railroads would neither tax the industries of the country nor have their own investments sacrificed; they would not build up one place or industry at the expense of some other place or industry; they would not take from some persons or commodities their proportionate share of the costs of transportation

and impose them upon other persons and commodities; and finally they would not by their system of rate making retard industrial progress or have their own development hindered by failing credit or lack of revenue.

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